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ABSTRACT

State and local tax performance in the United States and in the South and implications for the financing of public higher education are considered. It is suggested that despite apparent gains in state tax revenues, little overall growth in real terms has been experienced in the region and nation in recent years, nor can much be expected in the early 1980s. Additionally, statutory restraints and reductions in federal funding affect the adequacy of state and local sources of revenue. Public higher education in the Southern states, which in recent decades has fared above national averages in terms of state support, cannot be assured of drawing or increasing, or even continuing, shares of state tax revenues. Although measures imposing spending limitations or tax constraints have been voted down in many states, the number of states in which such measures have passed continues to grow. When utilization of tax ability is measured by comparison with average utilization by all states using a given tax, it is found that New England and the Middle Atlantic states generally continue to overutilize, while the North Central and the states comprising the Southern Regional Education Board underutilize. When increases in tax collections are adjusted for population growth and for inflation, the percent of real growth in state and local taxes increased less than 2 percent over the decade 1970-79. The use of selective sales taxes, general sales tax, property tax, corporation income tax, and personal income tax is examined. (SW)

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A Roundup of State and Local Tax Developments

The Current Tax Revenue Outlook

Despite apparent gains in state and local tax revenues, little overall growth in real terms has been experienced in recent years, nor can much growth be expected in the early 1980s. Inflation and unemployment remain at high levels, productivity has been on the decline, and personal and business incomes have fallen, relative to inflation. Because inflationary and recessionary momentum has been building over much of the last decade, the trends are not likely to be reversed in a short time. This raises issues about the role of state and local taxation in the financing of public higher education which are of increasing concern to education and government leaders. This discussion highlights implications of a recent Southern Regional Education Board compilation of information on state and local tax performance.*

Adding to the sluggish revenue outlook is the issue of broad fiscal constraints that became the focus of national attention in 1978, with the passage of Proposition 13 in California. Proposals for spending or taxing curbs continue, as the nation moves into the 1980s. Although eight of thirteen such initiatives were voted down by the voters in the 1980 general elections, indicating substantial preference for continuing public program support rather than cutting taxes, cuts in the future should not be ruled out.

Lagging transportation tax revenues pose problems for highway departments and other state agencies, and governors and legislators are being asked to appropriate state general tax funds to offset some of the highway fund losses, at least for the short term. With higher prices and more fuel-efficient cars cutting down on the amount of gasoline purchased, the revenues from per-gallon tax rates have naturally followed suit, and slumping automobile sales have added to highway tax shortfalls.

Another problem which is beginning to show at the state level is that of dealing with "uncontrollables" or "legislatively dedicated" spending, such as Medicaid-Medicare or court-mandated spending for prisons — expenditures on which current legislative discretion can be only minimal.

Finally, trends at the national level may place greater pressure on state and local finances if federal funds are pared. For example, the federal cutoff of state general revenue sharing ($2.3 billion in 1981) will certainly affect state tax policy. Budget surpluses, built up in more expansive times, largely had disappeared by early 1980, except in a few oil- and gas-producing states. In addition, the 1979-80 economic slowdown drastically reduced real tax collections in many states.

Real growth is not expected to return soon because of limited real economic growth and the reluctance of public officials to legislate tax increases. Because of selective tax paring and recession, about half of the states had revenue shortfalls in early 1980 and many had to trim budgets in mid-year to avoid going into the red. Higher education financing may prove to be vulnerable to tax shortfalls, if the past is any indication of the future. The 1970s was a period of leveling,

Table 1
State Appropriations for Higher Education Operations as a Percent of State Taxes 1970-71, 1974-75 and 1977-78

	1970-71	1974-75	1977-78
United States	13.5	14.0	13.5
SREB States	13.7	14.8	15.4
Alabama	10.5	17.4	19.5
Arkansas	14.5	12.6	13.6
Florida	15.2	14.8	13.0
Georgia	15.0	15.3	13.9
Kentucky	14.3	12.0	12.3
Louisiana	12.3	12.1	12.2
Maryland	10.5	12.1	11.3
Mississippi	13.9	16.4	18.9
North Carolina	13.6	18.4	17.7
South Carolina	12.9	19.4	16.6
Tennessee	13.4	15.1	14.4
Texas	15.6	14.7	19.5
Virginia	13.1	14.6	15.5
West Virginia	13.5	12.0	13.6

Source: SREB, *Fact Book on Higher Education in the South, 1979, and 1980.*

*A full set of the computer tables prepared for this report is available from SREB (Kenneth E. Quindry and Niles Schoening, *State and Local Tax Performance, 1979*, $3.00.)

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nationally, in the share of state appropriations allocated to higher education, although some states in the South have continued to gain (Table 1). Further leveling, including actual declines of state shares in some cases, may result from policy decisions or the consequences of slow revenue growth.

From 1970 to 1979, state and local taxes increased from $88.4 billion to $206.9 billion, an increase of 134 percent. When adjusted for inflation, growth averaged three percent per year, not enough to improve significantly the level of per capita public expenditures. From 1974 to 1975, and from 1978 to 1979, real tax collections actually declined. (A state comparison on taxes collected per $1,000 of personal income in 1979 is shown in Map 1.) Data comparing 1979 to 1980 are expected to show further decline because of minimum real growth and tax paring in several states.

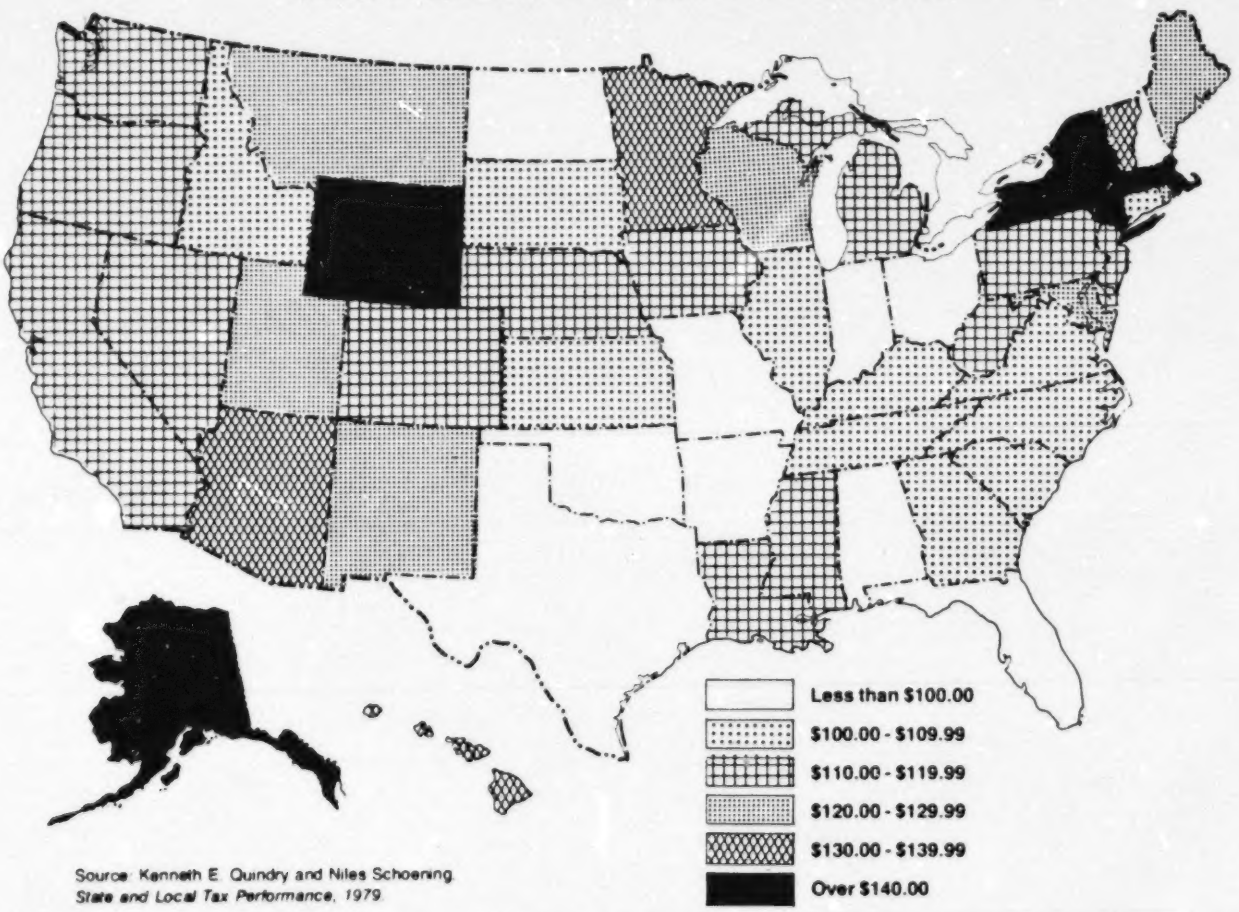
New Tax Developments, 1979-1980

The year 1979 saw dwindling state surpluses and efforts in many states to lessen the impact of inflation on taxpayers. Significant personal income tax rate changes were enacted in seven states. Three states, all outside the South, adopted indexing systems which adjust personal income tax rates for inflation. Property tax changes were numerous and involved enacting or extending exemptions and credits for homesteads, senior citizens, and alternative energy systems. In 1979, 20 states allowed adjustments for solar energy devices. In addition, 11 states allowed a deduction or a credit under the personal income tax, and five states allowed exemptions under the sales tax.

Gasoline tax rates increased in nine states. To counter the problem of falling gasoline revenues, a few states, such as Mississippi, have shifted gasoline taxes to a sales tax which climbs with rising prices, and more states may consider this in 1981. Cigarette tax rates increased in four states.

Most of these tax trends continued into 1980. Five more states increased gasoline tax rates in this year, and Kentucky, Indiana, and the District of Columbia indexed the fuel tax to wholesale prices. A new sever-

Map 1
State and Local Taxes Per $1,000 of Personal Income, 1979



Source: Kenneth E. Quindry and Niles Schoening, *State and Local Tax Performance, 1979*.

ance tax on resources other than coal and oil was enacted in Kentucky.

Several states with rapidly expanding coal production have taken advantage of that resource and levied significant coal severance taxes. However, proposed federal legislation (H.R. 6625) would limit these taxes to 12.5 percent of value, thus reducing the potential growth of these revenues.

The issue of broad fiscal constraints on state and local governments became the focus of attention in 1978 with the passage of California's Proposition 13. Six more states imposed spending limits in 1979, and Missouri was added to the list in 1980, bringing the total to at least 18 states with some form of spending limitation.

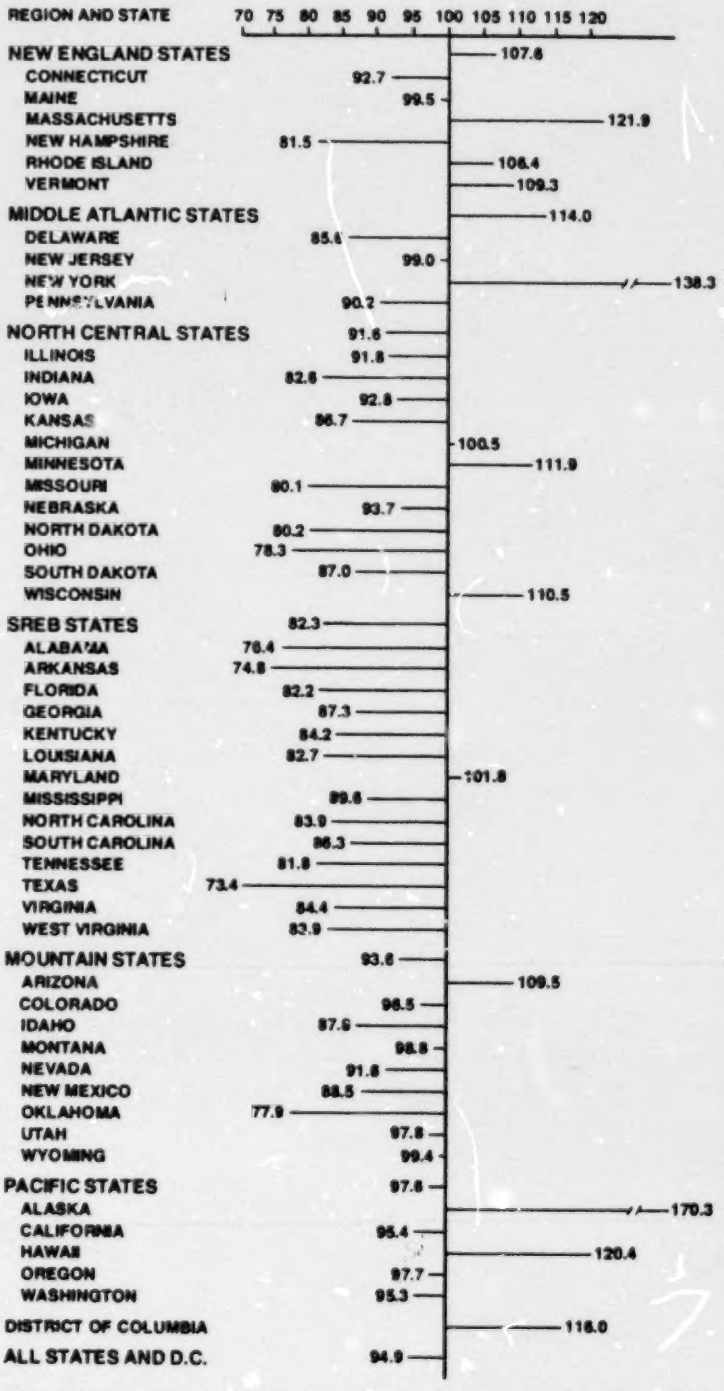
Fiscal constraints take the form of tax as well as spending limitations. Most major tax initiatives placed before the voters in November 1980 met defeat. Several of the proposals were continuations of earlier limitations. Twenty states now have Proposition 13-type constraints; five more were on the ballot in November, and all were defeated. However, not all tax limitation proposals voted on were defeated. Proposals to enact new property tax homestead exemptions or increase old ones were approved in Arkansas, Louisiana, New Jersey, Virginia, and West Virginia.

Caught between "grass roots" tax reform efforts, dwindling federal grant payments, and slow revenue growth because of the recession, many states and local governments now find themselves in a severe budget squeeze. According to a survey by the National Association of Tax Administrators, more than half the states had shortfalls in their tax collections in the spring of 1980. For example, the shortfall was 13 percent in Minnesota, 7.6 percent in Tennessee, 6.1 percent in Ohio, and 5.8 percent in Michigan. When the economy improves, much of this shortfall will be reduced; nevertheless, it seems certain that many states will face continuing budget austerity during this fiscal year and the next. But regardless of the revenue picture, higher education will increasingly be faced with competition for revenue resources in support of other pressing public services.

Regional and State Utilization of Tax Ability

As indicated in Chart 1, the states exhibited a wide range in the utilization of tax ability — from 73.4 percent in Texas to 170.3 percent in Alaska (a unique situation) and 138.3 percent in New York. In the analysis, a state was assumed to utilize its ability totally (100 percent on the chart) when it applied the full complement of average rates to its available tax bases. At that point, tax effort exactly equals tax ability, whether stated in percentage or in dollar amounts. States rank above 100 percent in utilization if the weighted average of all rates exceeds the 50-state averages. In most states, but not all, one or more taxes were "overutilized" in 1979 and one or

Chart 1
State and Local Utilization of Tax Ability,* By State and Region, 1979
(Percentage of Ability Utilized)



* Tax ability is equivalent to tax potential. It is stated in terms of the revenues that would be raised if the average rate(s) for all states using a tax (taxes) were applied, in a given state.

Source: Kenneth E. Quindry and Niles Schoening, *State and Local Tax Performance, 1979.*

more were "underutilized." Net underutilization indicates a theoretical potential for invoking tax increases to support desired public services. In all but nine states, and the District of Columbia, significant net underutilization was indicated for 1979.

The North Central and SREB regions continued to reflect a policy of low tax effort in 1979. In the SREB region, Alabama, Arkansas, and Texas were among the nation's lowest taxed states in terms of ability utilized, and Maryland is the only SREB state which exceeded the 50-state average in tax utilization. In the 14 SREB states, taxes were underutilized by $11 billion, and in the North Central region by $4.9 billion. Conversely, regional overutilization was evident in the New England region (primarily Massachusetts) by $905 million and in the Middle Atlantic region, by $5.3 billion. New York alone accounted for $6.7 billion in overutilization, while the other Middle Atlantic states indicated moderate to strong underutilization.

State Utilization of Taxes in Relation to Higher Educational Support

The degree to which tax ability or potential of a state is utilized in taxes actually collected is of major concern to public higher education, since state taxes provide the largest share of its support. Not unnoticed, however, is the fact that over the recent decades the Southern states, although generally underutilizing their tax ability, have generally exceeded national averages in level of support for higher education.

Strong financial commitments to the support of higher education, with relatively low utilization of tax ability, are evident both in higher per capita income states, such as Texas, and in the lower income states, such as Alabama. On the other hand, the SREB state with the highest utilization of tax ability — Maryland — supports its colleges and universities with one of the smallest higher educational shares of tax revenue in the region.

Table 2 presents a recent year's rankings of the SREB states according to level of tax utilization in relation to rankings of support, in terms of the revenue shares which those appropriations represent. Higher education in a state like Mississippi benefits from the best combination, within the limits of the state's resources — high tax utilization and also a large share of revenue. Arkansas higher education, on the other hand, receives a relatively small share of revenues which represent relatively low utilization.

For higher education, tuition increases are one immediate response, but in the short term, higher education has no choice but to adjust to the total resources which current systems of revenue make available. In a time of enrollment slowdown, this means a balancing of requests for expansion of some programs and contraction of programs in areas of declining need. Compounding higher education's problems is the fact that times of economic slowdown or recession — and sluggish state revenue growth — are usually times when more students enroll in college.

Growth in Real Ability and Effort

When adjusted for the rise in prices that states and local governments pay for goods and services, both ability and effort (collections) increased from 1970 to 1979 — ability by 26.1 percent and effort by 24.4 percent. Because of the sharper rise in ability than in actual collections, utilization declined nationally to 94.85 percent from 96.14 percent in 1970 (Table 3). The upward trends in ability and effort were interrupted in the nine-year span by two recessionary periods in which real economic growth actually declined. In both periods — 1974-75 and 1978-79 — utilization of ability was sharply curtailed.

Moreover, in these nine years, population increased an average of a percentage point a year (9.34 percent for the period) and real tax collections nearly three percent annually (24.4 percent for the period). This amounts to only a 1.67 percent growth in real per capita tax collections.

Table 2

Ranking of SREB States According to Utilization of Tax Ability and Share of State Revenues Supporting Higher Education, 1978

	Utilization of Tax Ability	Ranking of Higher Educational Share of Tax Revenues
Maryland	**99.2%**	**14**
Mississippi	**85.8**	**4**
Georgia	**83.5**	**8**
South Carolina	**82.6**	**5**
Virginia	**82.6**	**6**
North Carolina	**81.5**	**3**
Tennessee	**80.9**	**7**
Kentucky	**80.4**	**12**
Louisiana	**80.0**	**13**
Florida	**78.7**	**11**
West Virginia	**78.3**	**9**
Texas	**74.7**	**2**
Alabama	**74.4**	**1**
Arkansas	**73.9**	**10**

Sources: SREB, *Fact Book on Higher Education in the South, 1979 and 1980;* and Kenneth E. Quindry and Niles Schoening, *State and Local Tax Performance, 1978.*

Utilization of Major Tax Bases

There is a significant diversity in the relative use of taxes among the regions and among states within a region. The diversity is evident for 1979 in the data of

Table 3
State and Local Tax Ability and Effort, Selected Years 1970 to 1979 in Constant Dollars, United States (1972 = 100)

Year	Ability		Effort (Collections)		Percentage of Ability Utilized
	Amount (In Thousands)	Percentage Growth	Amount (In Thousands)	Percentage Growth	
1970	$104,912,037	—	$100,857,388	—	96.14
1974	120,613,245	3.74	116,126,528	3.79	96.28
1975	120,366,739	−0.20	114,774,746	−1.16	95.35
1977	129,596,948	3.83	123,601,662	3.85	95.37
1978	133,468,319	2.99	126,976,909	2.73	95.14
1979	132,251,016	−0.92	125,444,771	−1.21	94.85

Note: Deflators were the state-local deflators provided by the Bureau of the Census and projections provided by the University of Tennessee, Center for Business and Economic Research.

Sources: The University of Tennessee, Center for Business and Economic Research, 1979; and Kenneth E. Quindry and Niles Schoening, *State and Local Tax Performance, 1979.*

Table 4. Here is noted that the Southern states and the two Western regions utilized general and selective sales taxes heavily and income taxes lightly. The reverse is true in the East Coast regions. Property taxes were also utilized heavily on the East Coast and lightly in the SREB states.

Property tax effort averaged 73.7 percent of ability in the SREB states, ranging from 30.4 percent in Alabama to 94.7 percent in Texas. The range in non-SREB states was from 51.3 percent in Delaware to 182.1 percent in Massachusetts. Significantly, that state took steps in the November 1980 referendum to reduce dramatically its overutilization of property taxes.

Table 4
State and Local Utilization of Tax Ability, Major Tax Sources, 1979

Region and State	Percentage of Ability Utilized				
				Income Taxes	
	General Sales Taxes	Selective Sales Taxes	Property Taxes	Individual	Corporation
SREB States	**103.1**	**130.8**	**73.7**	**52.2**	**57.2**
Alabama	112.2	191.3	30.4	62.5	54.5
Arkansas	93.0	97.1	53.7	65.0	80.1
Florida	105.7	165.2	87.0	—	61.0
Georgia	110.0	95.7	81.9	80.7	84.2
Kentucky	92.7	100.7	52.2	101.5	90.2
Louisiana	157.4	97.4	40.1	34.3	102.6
Maryland	73.6	114.4	88.3	163.3	54.7
Mississippi	162.1	100.8	65.8	55.1	56.0
North Carolina	80.2	98.0	64.8	102.4	88.2
South Carolina	103.0	114.1	63.4	86.3	98.0
Tennessee	150.1	139.1	62.6	3.5	83.4
Texas	91.6	147.6	94.7	—	—
Virginia	65.1	135.4	76.7	92.6	63.3
West Virginia	160.9	122.9	51.4	65.9	26.1
New England States	**88.8**	**93.6**	**158.8**	**81.8**	**119.5**
Middle Atlantic States	**89.2**	**104.3**	**130.3**	**125.3**	**108.2**
North Central States	**84.9**	**77.3**	**102.9**	**85.7**	**90.1**
Mountain States	**122.0**	**99.4**	**96.6**	**63.3**	**57.8**
Pacific States	**123.0**	**73.7**	**86.6**	**85.8**	**137.9**
District of Columbia	**96.9**	**167.1**	**87.4**	**142.4**	**138.2**
All States and D.C.	**97.9**	**96.9**	**100.0**	**82.1**	**91.5**

Source: Kenneth E. Quindry and Niles Schoening, *State and Local Tax Performance, 1979.*

Summary

1. Despite apparent gains in state tax revenues, little overall growth in real terms has been experienced in the region and nation in recent years, nor can much be expected in the early 1980s.

2. Adding to the sluggish revenue outlook are the issues of statutory restraints, the reduction in revenue from gasoline taxes, the problem of "uncontrollable" expenditures, and various reductions in federal funding which affect the adequacy of state and local sources of revenue.

3. Public higher education in the Southern states, which in recent decades has fared above national averages in terms of state support, cannot be assured of drawing on increasing — or even continuing — shares of state tax revenues. The short-term prospects for adequacy of funding, during a time of changing enrollment, demands a balancing of expansion in selected necessary programs along with contraction of programs in areas of declining need.

4. Although measures imposing spending limitations or tax constraints have been voted down in many states, the number of states in which such measures have passed continues to grow; 20 states now have Proposition 13-type constraints and at least 18 have spending limitations.

5. When utilization of tax ability is measured by comparison with average utilization by all states using a given tax, it is found that New England and the Middle Atlantic states generally continue to "overutilize," while the North Central and the SREB states "underutilize."

6. When increases in tax collections are adjusted for population growth and for inflation, it is shown that percent of real growth in state and local taxes increased less than two percent over the decade 1970-79.

7. The SREB states have utilized selective sales taxes to a greater extent than any other region in the United States (31 percent above the average), were about average in utilization of the general sales tax, were lowest in the use of the property tax (20 percent below average), lowest in use of the corporation income tax (43 percent below average), and lowest in use of the personal income tax (48 percent below average).

This edition of *Financing Higher Education* is based on material provided by Kenneth E. Quindry and Niles Schoening of the Center for Business and Economic Research, College of Business Administration, The University of Tennessee, Knoxville.

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